

CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK

POLICY STAFF REPORT

ISSUE: Staff requests approval of the proposed Post-Issuance Tax Compliance Policy for Conduit Bonds (Qualified 501(c)(3) Bonds, Industrial Development Bonds and Exempt Facility Bonds) (Policy) to formalize post-issuance tax compliance procedures for such conduit bonds and delegate to the Executive Director authority to implement such policy and to consider and grant or deny requests for exceptions and waivers, where appropriate, in order to effectively carry out the duties of the I-Bank as an issuer of conduit bonds. (See Attachment A—Proposed Policy.)

BACKGROUND: The Bergeson-Peace Infrastructure and Economic Development Bank Act (Act) authorizes the I-Bank, among other things, to issue tax-exempt Qualified 501(c)(3) Revenue Bonds, Industrial Development Revenue Bonds and Exempt Facility Revenue Bonds (Conduit Private Activity Bonds) as well as tax-exempt State and Local Governmental Bonds (Governmental Bonds or Public Agency Revenue Bonds), which includes the direct issuance of bonds for the I-Bank's own programs such as the Infrastructure State Revolving Fund Program (ISRF Program Bonds). The I-Bank plans to formalize post issuance tax compliance policies for Governmental Bonds and the I-Bank programs bonds for the Board's consideration at a future I-Bank Board meeting.

The I-Bank's role as an issuer of Conduit Private Activity Bonds is to provide eligible borrowers access to tax-exempt financing from the public capital markets. When the I-Bank issues a Conduit Private Activity Bond for an eligible borrower (Borrower), the obligation to repay bondholders and comply with tax compliance requirements is "passed through" to the Borrower.

Pursuant to federal tax law, interest paid to bondholders of Conduit Private Activity Bonds may be excluded from gross income for federal income tax purposes if certain tax compliance requirements are met by the Borrower. Interest paid to bondholders on such bonds is also often exempt from State taxes as well. While Conduit Private Activity Bond compliance with applicable tax requirements is generally the responsibility of the Borrower, as the issuer the I-Bank is involved on some level as it is considered to be the "taxpayer" of record before the Internal Revenue Service (IRS) for certain filing purposes and in any audits or investigations.

In connection with developing its guidance on post-issuance tax compliance, in 2009, the IRS distributed questionnaires to nonprofit corporations and state and local governments seeking information regarding post-issuance compliance efforts for maintaining the federal tax exemption of interest on various types of tax-exempt bonds, including information on internal compliance policies, procedures and recordkeeping functions. The I-Bank actively participated and submitted several responses to the questionnaire.

As a result of various efforts by the IRS, including evaluation of the responses to completed questionnaires received, the IRS developed recommendations and guidelines that encourage conduit bond issuers to adopt written procedures that alert and remind the Borrower of post issuance tax compliance obligations.

Tax Compliance Requirements. For all tax-exempt bond transactions, federal tax law requirements associated with the tax-exempt status of the bonds are set forth in a Tax Certificate or Agreement (Tax Certificate) that is prepared by bond counsel for the bonds and reviewed by other legal counsel on the transaction. In the case of Conduit Private Activity Bonds, nearly all of the requirements identified in the Tax Certificate are obligations of the Borrower, and by its own provisions, the Tax Certificate provides that the I-Bank may and does rely on the representations and covenants of the Borrower for ensuring post-issuance compliance.

POLICY FORMULATION: The Policy contains procedures addressing four major areas of federal tax requirements:

1. Arbitrage rebate and yield restriction.
2. Use of bond proceeds and bond-financed or re-financed assets (including remedial action, if necessary).
3. Record keeping requirement.
4. IRS information filings.

The Policy also includes procedures that require the Borrower to consult with a rebate consultant as well as legal counsel and other external advisors to identify tax requirements and to establish the practices necessary or appropriate so that, upon issuance and for the life of the bonds, such bonds will qualify for tax-exempt status, and to document those requirements and procedures in a Tax Certificate and/or other legal document.

If approved by the Board, the Policy will require the Borrower to acknowledge the receipt of the Policy as a condition to closing a bond transaction and will allow the I-Bank to indicate on the IRS Form 8038 for a Conduit Private Activity Bond that, it, as the issuer has established procedures to ensure compliance by the Borrower with post-issuance tax requirements.

In order to effectively carry out the duties of the I-Bank as an issuer of conduit bond, the Policy allows the Executive Director the authority to not only implement the Policy, but also to consider and grant or deny requests for exceptions and waivers, where appropriate. However, in the event that such exceptions or waivers are granted by the Executive Director, the Policy requires the Executive Director to report such action to the Board as soon as practicable

Lastly, the Policy includes a direction to the Executive Director to periodically, as necessary or appropriate, request Board review of the Policy in order to provide the Board with the opportunity to reassess the merits of the Policy.

Review Of Other Post-Issuance Policies And Expert Assistance Received.

While developing the Policy, Bond Unit staff along with Legal Unit staff reviewed similar post-issuance policies of other state agencies and financing entities in California and other states as well as policy guidelines published by the IRS, National Association of Bond Lawyers and bond counsel firms. The I-Bank's legal staff also obtained Policy input from a specialized tax attorney at a special counsel firm under contract to the I-Bank.

RECOMMENDATION: Staff recommends approval of Resolution 12-05 approving the Post-Issuance Tax Compliance Policy for Conduit Bonds (Qualified 501(c)(3) Bonds, Industrial Development Bonds and Exempt Facility Bonds) dated June 26, 2012, to formalize post-issuance tax compliance procedures for conduit bonds and delegate to the Executive Director authority to implement such policy as necessary in order to effectively carry out the duties of the I-Bank as an issuer of Conduit Private Activity Bonds.

ATTACHMENT A—PROPOSED POLICY

California Infrastructure and Economic Development Bank Post-Issuance Tax Compliance Policy For Conduit Bonds (Qualified 501(c)(3) Bonds, Industrial Development Bonds and Exempt Facility Bonds)

June 26, 2012

The purpose of the Post-Issuance Tax Compliance Policy (“Policy”) is to establish procedures to aid the California Infrastructure and Economic Development Bank (“I-Bank”) in ensuring that entities (each, a “Borrower”) that borrow the proceeds of qualified I-Bank bonds for 501(c)(3) organizations, industrial development bonds and exempt facility bonds (“Bonds”) comply with applicable post-issuance requirements of federal income tax law necessary to preserve the tax-exempt status of interest on the Bonds. The I-Bank reserves the right to use its discretion as necessary and appropriate to make exceptions or request additional provisions as circumstances warrant. The I-Bank also reserves the right to change these policies and procedures from time to time.

Post-Issuance Compliance Requirements

A. External Advisors / Documentation

For each issue of Bonds, the I-Bank and the Borrower shall consult with bond counsel and other legal counsel and advisors, as needed, throughout the Bond issuance process to identify requirements and to establish procedures necessary or appropriate so that, upon issuance, the Bonds will qualify for tax-exempt status. Those requirements and procedures shall be documented in the tax certificate and agreement (“Tax Certificate”) and/or other documents finalized at or before issuance of the Bonds. Those requirements and procedures shall include future compliance with applicable arbitrage rebate requirements and certain other applicable post-issuance requirements of federal tax law throughout (and in some cases beyond) the term of the Bonds.

Following issuance of the Bonds, the Borrower also shall consult with bond counsel and other legal counsel and advisors, as needed, to ensure that all applicable post-issuance requirements in fact are met. This shall include, without limitation, consultation in connection with any potential changes in use of Bond-financed or refinanced assets.

The I-Bank shall require the Borrower to engage expert advisors (each a “Rebate Service Provider”) to assist in the calculation of arbitrage rebate payable in respect of the investment of Bond proceeds, unless the Tax Certificate documents that arbitrage rebate will not be applicable to an issue of Bonds.

Unless otherwise provided by the indenture relating to the Bonds, unexpended Bond proceeds shall be held by a trustee or other financial institution, and the investment of Bond proceeds shall be managed by the Borrower. The Borrower shall prepare (or cause

the trustee to prepare) regular, periodic statements regarding the investments and transactions involving Bond proceeds.

B. Arbitrage Rebate and Yield

Unless the Tax Certificate documents that arbitrage rebate will not be applicable to an issue of Bonds, it is the I-Bank's policy that the Borrower shall be solely responsible for:

- engaging the services of a Rebate Service Provider and, prior to each rebate calculation date, causing the trustee or other financial institution to deliver periodic statements concerning the investment of Bond proceeds to the Rebate Service Provider;
- providing to the Rebate Service Provider additional documents and information reasonably requested by the Rebate Service Provider;
- monitoring efforts of the Rebate Service Provider;
- assuring payment of required rebate amounts, if any, no later than 60 days after each 5-year anniversary of the issue date of the Bonds, and no later than 60 days after the last Bond of each issue is redeemed;
- during the construction period of each capital project financed in whole or in part by Bonds, monitoring the investment and expenditure of Bond proceeds and consulting with the Rebate Service Provider to determine compliance with any applicable exceptions from the arbitrage rebate requirements during each spending period following the issue date of the Bonds and in compliance with the requirements of the Internal Revenue Code (the "Code") and any related Internal Revenue Service Regulations ("IRS Regulations"); and
- retaining copies of all arbitrage reports, investment records and trustee statements as described below under "Record Keeping Requirements."

C. Use of Bond Proceeds and Bond-Financed or Refinanced Assets:

It is the I-Bank's policy that the Borrower shall be solely responsible for:

- monitoring the timely expenditure and use of Bond proceeds (including investment earnings and including reimbursement of expenditures made before bond issuance) and the use of the Bond-financed or refinanced assets throughout the term of the Bonds to ensure compliance with covenants and restrictions set forth in the Tax Certificate relating to the Bonds;
- maintaining records identifying the assets or portion of assets that are financed or refinanced with proceeds of each issue of Bonds (including investment earnings and including reimbursement of expenditures made before bond issuance),

including a final allocation of Bond proceeds as described below under “Record Keeping Requirements”;

- consulting with bond counsel and other legal counsel and advisers in the review of any change in use or transfer of Bond-financed or refinanced assets to ensure compliance with all covenants and restrictions set forth in the Tax Certificate relating to the Bonds;
- designating an individual by title (the “Tax Compliance Officer”) in the space provided in Exhibit A hereto to act as the person responsible for coordinating on the Borrower’s post-issuance tax compliance obligations in connection with the Bonds;
- adopting procedures and conferring at least annually with the Tax Compliance Officer to identify and discuss any existing or planned use of Bond-financed or refinanced assets, to ensure that those uses are consistent with all covenants and restrictions set forth in the Tax Certificate relating to the Bonds; and
- to the extent that the Borrower discovers that any applicable tax restrictions regarding use of Bond proceeds and Bond-financed or refinanced assets will or may be violated, consulting promptly with bond counsel and other legal counsel and advisers to determine a course of action to preserve the tax-exempt status of the Bonds.

All relevant records and contracts shall be maintained as described below.

D. Record Keeping Requirement

It is the I-Bank’s policy that the Borrower shall be solely responsible for maintaining the following documents for the term of each issue of Bonds (including refunding Bonds, if any) plus at least three years:

- a copy of the Bond closing transcript(s) and other relevant documentation delivered to the Borrower at or in connection with closing of the issue of Bonds;
- a copy of all material documents relating to capital expenditures financed or refinanced by Bond proceeds, including (without limitation) construction contracts, purchase orders, invoices, trustee requisitions and payment records, as well as documents relating to costs reimbursed with Bond proceeds and records identifying the assets or portion of assets that are financed or refinanced with Bond proceeds, including a final allocation of Bond proceeds; and
- a copy of all records of investments, investment agreements, credit enhancement transactions, financial derivatives, arbitrage reports and underlying documents, including trustee statements, in connection with any investment agreements, and copies of all bidding documents, if any.

E. IRS Information Return Filings

The Borrower will assure the filing of information returns on IRS Form 8038 or any other applicable form, no later than the 15th day of the second calendar month in the following calendar quarter commencing after the date on which each series of Bonds is issued. As the issuer of the Bonds, the I-Bank signs the Form 8038.

F. Borrower Acknowledgement:

As a condition to closing, the I-Bank shall require each Borrower to acknowledge its receipt of this Policy as set forth in the attached Exhibit A.

Exhibit A
Borrower Acknowledgement

**Borrower Acknowledgment Regarding
I-Bank Post Issuance Tax Compliance Policy**

Borrower Name: _____ (the “Borrower”)

Name of Bond Issue:

Expected date of closing: _____

In connection with the issuance of the above reference bonds (the “Bonds”), the undersigned authorized representative of the Borrower hereby acknowledges receipt of the I-Bank’s Post-Issuance Tax Compliance Policy (the “Policy”) and agrees to comply with all the requirements of the Policy that are applicable to it during the term of the Bonds.

In accordance with the requirements of the Policy, the individual identified below is hereby designated as the Tax Compliance Officer for the Bonds.

Title of individual designated as Tax Compliance Officer: _____

Signature: _____

Name: _____

Title: _____

Date: _____